Office of Chief Counsel Internal Revenue Service

memorandum

CC:LM:CTM:SF:POSTF114951-02
GMFerreira

date: April 15, 2002

to: Mark Mertens, Senior Team Coordinator, (LMSB) Internal Revenue Service Stop SF-6107; EG 1232 450 Golden Gate Avenue San Francisco, CA 94102

from: Area Counsel

(Communications, Technology, and Media: Oakland)

subject:

Corporation and Includible Subsidiaries

Tentative Refund of Net Operating Losses FYE

and

Disclosure Statement

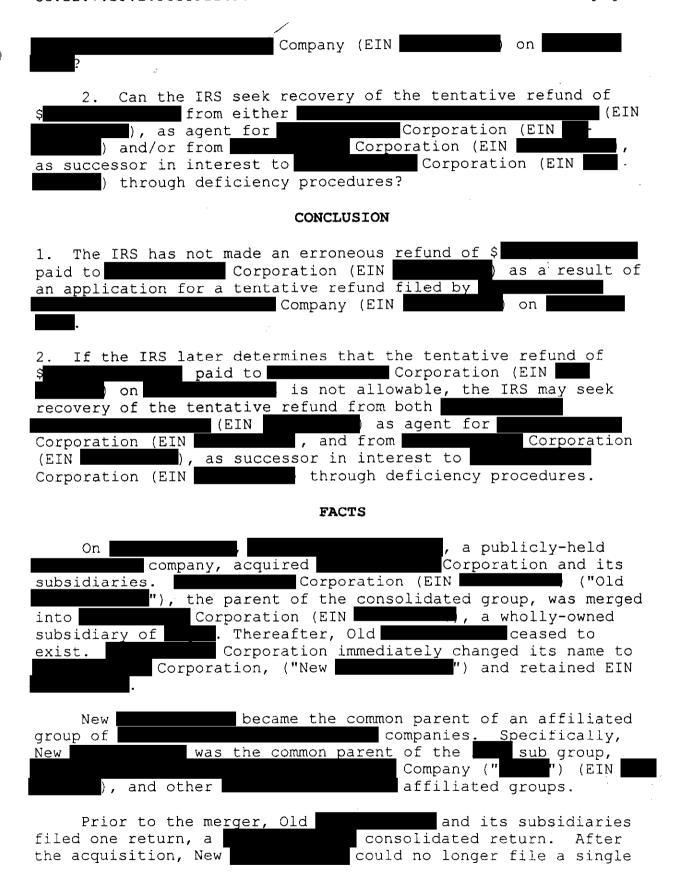
This writing may contain privileged information. Any unauthorized disclosure of this writing may have an adverse effect on privileges, such as the attorney/ client privilege. If disclosure becomes necessary, please contact this office for our recommendations.

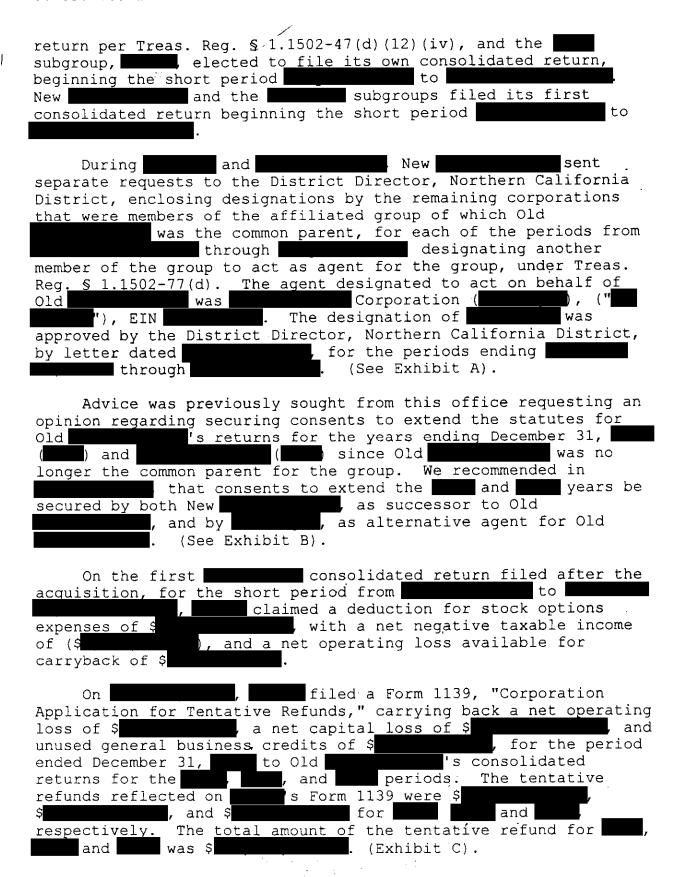
This advice relies upon facts provided by you to our office. If you find that any facts are incorrect, please advise us immediately so that we may modify and correct this advice. We have assumed that there are no changes in the taxpayer's organizational structure that would affect the conclusions reached in this memo.

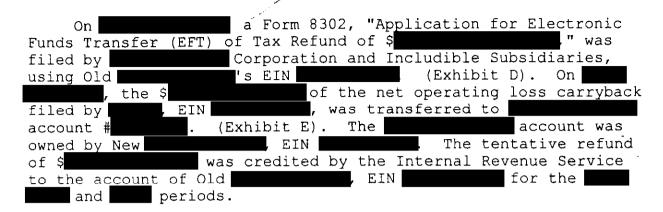
This advice is subject to the 10-day post-review by the National Office pursuant to CCDM 35.3.19.4. Accordingly, we request that you do not act on this advice until we have advised you of the National Office's comments concerning this advice.

ISSUE

1. Has the IRS made an erroneous refund of \$ paid to Corporation (EIN as a result of an application for a tentative refund filed by







DISCUSSION

Issue 1: Erroneous Refund

I.R.C. § 7405 allows the United States to recover any portion of a refund that has been erroneously made to a taxpayer. The statute of limitations for filing an erroneous refund claim against New for the recovery of the \$ tentative refund will expire on I.R.C. § § 6532(b) and 7405.

I.R.C. § 6411(a) authorizes a corporation that has sustained a net operating loss (NOL) to apply for a tentative carryback adjustment of the tax for the prior taxable year to which the NOL is carried. The application of I.R.C. § 6411, however, is subject to such conditions, limitations, and exceptions as prescribed by regulation when the applicant made, or was required to make, a consolidated return either for the year in which the NOL arose, or for the prior taxable year to which the NOL is carried. See I.R.C. § 6411(c) and Treas. Reg. § 1.6411-4.

The predecessor of I.R.C. § 6411 was enacted in 1945, and the Committee Report declared its purpose was to make funds available promptly to corporations that needed them. H. Rept. No. 849, 79th Cong., 1st Sess., 1945 C. B. 566, 569. To assure that the Internal Revenue Service would act promptly on such an application, I.R.C. § 6411(b) requires the government to act within a 90-day period and limits the scope of IRS's review to an "examination of the application, to discover omissions and errors of computation therein." However, because the government's review of the application is limited, the allowance of an adjustment is tentative. H. Rept. No. 849, supra at 1945 C. B. 580-583. To facilitate the recovery of an adjustment which the IRS later determines to have been erroneous, the IRS may assess a deficiency as if it were due to a mathematical error under I.R.C. § 6213(b)(2) without providing the taxpayer with an opportunity

to dispute the assessment. Yet, such method of recovering an erroneous refund is not exclusive; the IRS may send a notice of deficiency and provide the taxpayer with an opportunity to challenge the deficiency before the Tax Court. H. Rept. No. 849, supra at 1945 C. B. 583.

The issue in this case is whether the tentative NOL carryback refund, filed by the successor common parent to Old the successor common parent to Old the successor common parent of the tentative refunds as the successor common parent for the group.

Treas Reg. § 1.1502-77(a) provides that the common parent is the "sole agent" for the consolidated group with respect to most procedural tax matters relating to the group's tax liability for a consolidated return year, including filing claims for refund. If the common parent for the group ceases to exist, Treas. Reg. § 1.1502-77(d) provides that the dissolving common parent may designate a member of the group to serve as "agent" for the group, and such designation must be approved by the IRS. In this case, Old designated to serve as "agent" for the groups' pre-merger years, and such designation was approved by the Internal Revenue Service on which was prior to the application for tentative refund, which was filed on

Treas. Reg. § 1.1502-78 contains the rules applicable to consolidated groups when a claim for a tentative carryback adjustment has been filed.

Treas Reg. § 1.1502-78, provides, in part, as follows:

(a) General Rule. -- If a group has a consolidated net operating loss, a consolidated net capital loss, or a consolidated unused investment credit for any taxable year, then any application under section 6411 for a tentative carryback adjustment of the taxes for a consolidated return year or years preceding such year shall be made by the common parent corporation to the extent such loss or unused investment credit is not apportioned to a corporation for a separate return year pursuant to § § 1.1502-21(b), 1.1502-22(b), or 1.1502-

79(c) (or § § 1.1502-79A(a), 1.1502-79A(b), or 1.1502-79A(c), as appropriate).

application for an NOL carryback, the Form 1139, for years that preceded the merger of Old into New was the corporation to which the NOL carryback was attributable. Treas. Reg. § 1.1502-78 currently permits the corporation to which the loss or credit is attributable, to file the application for an NOL carryback refund.

Though was not the common parent of the new groups, the application for transfer of funds, the Form 8302, was filed by New groups. The successor common parent of the groups. The payment of the tentative refund of \$ was actually paid by the IRS to a bank account owned by, and in the name of, New

Under Treas. Reg. § 1.1502-78 (b), the regulations currently specify that any refund that is claimed under Treas. Reg. § 1.1502-78 (a) shall be paid to the common parent corporation. Specifically, the regulation states:

(b) Special Rules.--(1) Payment of refund. Any refund allowable under an application referred to in paragraph (a) of this section shall be made directly to and in the name of the corporation filing the application, except that in all cases where a loss is deducted from the consolidated taxable income or a credit is allowed in computing the consolidated tax liability for a consolidated return year, any refund shall be made directly to and in the name of the common parent corporation. The payment of any such refund shall discharge any liability of the Government with respect to such refund. [Emphasis added.]

The Tax Court has had difficulty applying the rules applicable to consolidated groups following a group structure change, under Treas. Reg. § 1.1502-75(d), where certain members of the group continue to exist and a new common parent has replaced the former common parent. See Interlake Corp. v. Commissioner, 112 T.C. 103 (1999); Union Oil Co. v. Commissioner, 101 T.C. 130 (1993); Southern Pacific Co. v. Commissioner, 84 T.C. 395 (1985).

In <u>Interlake Corp. v. Commissioner</u>, 112 T.C. 103, 112-113 (1999), the Tax Court found that Treas. Reg. § 1.1502-78(b) is

unclear as to whether the a tentative carryback refund should be made to the common parent in the carryback year or the common parent in the loss year, especially when the common parent for the carryback year was no longer affiliated with the group. The Court held that the former common parent of an affiliated group during the carryback year, that no longer remains affiliated with the group, cannot receive tentative refunds under Treas. Reg. § 1.1502-78(b). Thus, "common parent," as it appears in Treas. Reg. § 1.1502-78(b), means the successor common parent for the group. Id.

As a result, the Internal Revenue Service currently has proposed amendments to Treas. Reg. § § 1.1502-77 and 1.1502-78 to specify which corporation should file a claim for a refund on behalf of a consolidated group and to specify to which corporation the tentative refund shall be paid. For example, the proposed regulations amend Treas. Reg. § 1.1502-78(a) to provide that the common parent for the carryback year should file any application under I.R.C. § 6411 for a tentative carryback adjustment instead of the corporation to which the loss is attributable. In addition, the proposed amendments under Treas. Reg. § 1.1502-78(b) clarify that any refund under Treas. Reg. § 1.1502-78(a), related to a tentative carryback adjustment, must be paid to the corporation that was the common parent for the carryback year or, in the alternative, to the designated agent under Treas. Reg. § 1.1502-77(d). See Prop. Treas. Reg. \$ \$ 1.1502-78(a) and (b).

In this case, if we were to follow the proposed amendments to Treas. Reg. § 1.1502-78(a), the claim for tentative refund, filed by on since Old was the common parent for the carryback year. Furthermore, if we were to follow the proposed amendments to Treas. Reg. § 1.1502-78(b), the refund should have been paid to the common parent during the carryback years () and (), which was Old or, since Old no longer existed, to the designated agent per Treas. Reg. § 1.1502-77(d), which was

We have confirmed with the National Office that the proposed amendments to Treas. Reg. § § 1.1502-78 (a) and (b) have not been adopted and are not applicable to the years at issue in this case. Specifically, the proposed regulations state that the changes apply to taxable years to which a loss or credit may be carried back and for which the due date of the original tax returns is after the date the final regulations are published in the Federal Register. Since the proposed amendments to Treas. Reg. § § 1.1502-78 (a) and (b) have not

yet been published as Final Regulations, we recommend following the regulations currently in effect under Treas. Reg. §§ 1.1502-78(a) and (b).

Thus, we do not consider an erroneous refund to have been made under the facts and circumstances contained herein.

Issue 2: Notice of Deficiency Procedures to Recover NOL Carryback Refund

I.R.C. § 6411 was first enacted as § 3780 of the Internal Revenue Code of 1939 by the Tax Adjustment Act of 1945 (Act of July 31, 1945, ch. 340, 59 Stat. 521) and was accompanied by a Committee Report (H. Rept. No. 849, 79th Cong., 1st Sess. (1945), 1945 C. B. 566, 580-583) which emphasized the tentative character of adjustments made pursuant thereto. Referring specifically to subsection (c) of 1939 Code Section 3780--the predecessor of I.R.C. § 6213(b)(2), which authorizes the assessment as mathematical errors of deficiencies attributable to tentative carryback adjustments-the Committee Report states (1945 C. B. at 583):

It is to be noted that the method provided in subsection (c) of section 3780 to recover any amounts applied, credited, or refunded under section 3780 which the Commissioner determines should not have been so applied, credited, or refunded is not an exclusive method. It is contemplated that the Commissioner will usually proceed by way of a deficiency notice in the ordinary manner, and the taxpayer may litigate any disputed issues before the Tax Court. The Commissioner may also proceed by way of a suit to recover an erroneous refund.

If the Commissioner determines that an amount which has been refunded pursuant to I.R.C. § 6411 should not have been so

refunded, he may seek to assess such amount as a deficiency in at least three distinct ways. He may assess such amount as a deficiency as if it were due to a mathematical error appearing on the return under I.R.C. § 6213(b)(2), or he may proceed by way of a deficiency notice in the usual manner. Union Equity Cooperative Exchange v. Commissioner, 58 T.C. 397 (1972); John S. Neri v. Commissioner, 54 T. C. 767, 770-771 (1970); Frank B. Polachek v. Commissioner, 22 T. C. 858, 863-865 (1954). Furthermore, the Commissioner may seek to recover the refund if he determines it was erroneous, under the procedures outlined above, pursuant to I.R.C. § 7405.

The Tax Court has held, that when as a result of an application for a tentative carryback adjustment, a refund is paid to a transferee of the corporation sustaining the loss, the Internal Revenue Service may use the notice of deficiency procedure to recover such refund if he later determines that it was erroneous. Collegiate Cap and Gown Company v. Commissioner, 59 T.C. 449 (1972).

Accordingly, if it is later determined that the NOL carryback adjustments, claimed by on the Form 1139, but paid to New on allowable, we recommend that you make the necessary adjustments to the consolidated returns in the notices of deficiency, if any, issued for the _____, and _____ periods. Per our memorandum to you from Marion Robus, dated October 18, 2001, we recommend, for the reasons stated therein, that the notices of deficiency be issued to both New (EIN# successor to Old (EIN#), and as alternative agent for (EIN#). Treas. Reg. § 1.1502-77T. Old (EIN#

If you have any questions with regard to this memorandum, please do not hesitate to contact me at (415) 744-9211.

LAUREL M. ROBINSON
Associate Area Counsel
(Large and Mid-Size Business)

By:
G. MICHELLE FERREIRA
Attorney (LMSB)

Attachments: Exhibits A through G

cc: Office of Chief Counsel (via e-mail and regular mail)
 Internal Revenue Service
 1111 Constitution Avenue, N.W.
 Room 4510
 Washington, D.C. 20224

William Sabin (via e-mail) Senior Legal Counsel (LMSB)

James Clark (via e-mail) Area Counsel (Oakland)